



Investment Newsletter

Fourth Quarter 2020

U.S. and international equity markets performed strongly during the quarter, continuing the recovery off the March lows at the onset of the global pandemic. Performance was driven by better-than-expected COVID-19 vaccine effectiveness data from the two leading vaccine candidates, quick authorizations of those two vaccine candidates by health regulators in the U.S. and U.K., a resolution to the U.S. Presidential election, a new bipartisan COVID-19 relief bill passed by Congress, and a continuation of strong economic improvement on a global basis – all occurring while new COVID-19 cases reaccelerated to all-time highs in both the U.S. and Europe, prompting new restrictions on economic activity.

Index	4 <sup>th</sup> Quarter	2020
<b>Equity</b>		
S&P 500	+12.01%	+17.61%
MSCI All-Country World ex-U.S.	+17.01%	+10.57%
<b>Fixed Income</b>		
Bloomberg Barclays U.S. Intermediate Government/Credit	+0.48%	+6.38%
Bloomberg Barclays Municipal Bond 1-5 Year Blend	+0.44%	+3.13%

Fixed income performance was also positive for both the quarter and the full-year, driven by a pandemic-inspired flight to safety and unprecedented monetary support from the Federal Reserve. The Federal Funds rate was cut to 0.00-0.25% back in March, which began a remarkable decline in rates to low levels last seen in the 1940s. Real Treasury yields are actually negative when factoring in inflation.

To ensure that the fixed income markets functioned smoothly, the Federal Reserve also instituted several programs to directly purchase Treasuries, corporates, ETFs and other securities, as well as to provide loans to states and municipalities.

These programs provided strong support to bonds, driving yields on all Treasuries and municipals with maturities under 11 years to below 1.00%. Corporate and taxable municipal bonds outperformed both Treasuries and tax-exempt municipal bonds. Taxable municipal bonds benefitted from increased issuance and were seen by investors as a high-quality alternative to corporate bonds. Tax-exempt bonds were held back by credit concerns related to the decline in state and local revenues tied to COVID-19.

Looking forward, the Federal Reserve has repeatedly expressed its intent to keep interest rates low through 2023, which should hold down interest rates on shorter maturities. However, we expect to see interest rates rise on longer maturities as the economy rebounds and inflation gradually increases.

For these reasons, we continue to maintain a conservative posture in client fixed income portfolios by investing in high quality, liquid, and relatively short maturity bonds. Our key objectives are preserving capital and maintaining a reliable income stream.

After a tumultuous year catalyzed by a once-in-a-century global pandemic, people are looking forward with great hope to better times ahead. There are several positive developments expected in 2021, including multiple COVID-19 vaccine launches, sharply rebounding U.S. economic and corporate earnings growth, and sizable fiscal and monetary support left to aid the economic recovery.

Of the five key COVID-19 vaccines in late-stage development, two were recently granted emergency use authorization from the FDA - Pfizer/BioNTech's and Moderna's. In addition, AstraZeneca/University of Oxford recently received authorization for their vaccine in the U.K., and Johnson & Johnson and Novavax are expected to release their Phase 3 efficacy data in the first quarter. If these three additional vaccines receive FDA authorization, they would add 6B in additional manufactured doses, resulting in a total of 7.9B doses for 2021, enough to vaccinate 4.5B people, or 59% of the world's population. Assuming all doses were used, that would get the world close to the 60-70% range of herd immunity in most models.

After an estimated -3.6% decline in 2020, U.S. real GDP growth is forecasted to grow +4.1% in 2021 (FactSet). S&P 500 earnings growth is also forecasted to rebound sharply by +22% in 2021 after an estimated -16% decline in 2020 (FactSet) based on easy comparisons, continued government stimulus, and a gradual resolution to the COVID-19 global pandemic.

Fiscal support from Congress and monetary support from the Federal Reserve have been extraordinary, and investors are expecting that to continue for the duration of the pandemic. Administrative and legislative actions have committed an unprecedented \$4.7T, of which \$3.0T has been spent thus far (excludes the recently passed \$920B Coronavirus Response and Relief Act). Additionally, the Federal Reserve's actions have committed \$7.3T, of which \$2.5T has been utilized (as of December 21, 2020; Committee for a Responsible Federal Budget). Moreover, with the Democrats projected to win majority control of the Senate, investors are expecting even more fiscal stimulus as the number one legislative priority. Other priorities, such as tighter corporate regulation and increased corporate, personal income and capital gains taxes, are expected to be delayed and/or tempered in their severity.

Despite what is expected to be a better year, the following risks lie ahead: two new mutations of the SARS-coV-2 virus that could prolong the pandemic by rendering current vaccines less effective; lower-than-expected durability of immunity conveyed by COVID-19 vaccines; a high current valuation for the S&P 500 (22.0x forward price-to-earnings ratio vs. its 10-year average of 15.7x); an escalating new Cold War between the U.S. and China; and continued strife over racial, wealth and income inequality.

While the tremendous recent performance and high valuation of the stock market have diminished the risk/reward profile of the stock market, the expectation of significant fiscal stimulus from Congress coupled with a commitment to low interest rates from the Federal Reserve, continues to make the investment environment for stocks a favorable one. We are determined to prudently navigate this challenging environment by remaining steadfast to our disciplined investment process, which was designed to first mitigate risk. It does this by focusing on larger, established companies; the most compelling long-term secular trends; by eliminating companies that do not produce free cash flow; and by avoiding companies with excessive debt and unsustainable business practices.

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